

**SUMMARY OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM
INVESTMENT COMMITTEE**

**HELD ON
Wednesday, December 5, 2007
3:30 p.m., MST**

The Investment Committee (IC) of the Arizona State Retirement System (ASRS) met at 3300 N. Central Avenue, 14th Floor Conference Room, Phoenix, Arizona 85012. Mr. Lawrence Trachtenberg, Chair of the IC, called the meeting to order at 3:45 p.m., MST.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Lawrence Trachtenberg, Chair
Mr. Christopher Harris (joined at 4:42 p.m., via telephone)
Mr. Thomas Connelly
Mr. James McLaughlin

A quorum was present for the purpose of conducting business.

Mr. Lawrence Trachtenberg stated that agenda item 2 would be discussed first, followed by agenda item 4, to accommodate the schedule and allow the participation of Mr. Terry Dennison, Worldwide Partner, Mercer Investment Consulting, Inc.

2. Presentation, Discussion, and Appropriate Action Regarding the Contract of Franklin Portfolio Associates, an ASRS U.S. Equity Mid Cap Manager

Mr. Gary R. Dokes, Chief Investment Officer (CIO), introduced the topic. The Investment Management Division (IMD) recommends terminating Franklin Portfolio Associates' U.S. Equity Mid-Cap (MC) mandate and transitioning the Franklin mid-cap portfolio of approximately \$394 million to State Street Global Advisors, ASRS' passive mid-cap equity portfolio manager, until a search occurs to identify a replacement active mid-cap core equity manager.

Mr. Dan Kapanak, Manager of Investment Strategy, elaborated on the background leading to this recommendation. The recommendation to terminate Franklin's U.S. Equity Mid-Cap mandate is based on a re-assessment of their quantitative stock selection model and an anticipation of further portfolio underperformance relative to the S&P 400 Index. The ASRS feels that Franklin's factor model needs to be updated. Although Franklin appears committed to research, they have made no changes to their models in recent quarters. Therefore, the ASRS is concerned that Franklin's models may not be as effective in today's market as they were in the past.

Mr. Dennison stated that Franklin's performance was negative in five of the past six quarters and that Mercer supports staff's recommendation to terminate Franklin.

Mr. Dokes reiterated that the main reasons for this recommendation are Franklin's poor performance and stale factor model.

Mr. Kapanak noted that it can take a year or more to add a new factor into the model. He said that the underperformance seems to be due to inverted models, as opposed to market conditions.

Motion: Mr. McLaughlin moved to recommend that the Board:

- Terminate Franklin Portfolio Associates' U.S. Equity Mid-Cap (MC) mandate.
- Transition the Franklin mid-cap portfolio of approximately \$394 million to State Street Global Advisors, ASRS' passive mid-cap equity portfolio manager, until a search occurs to identify a replacement active mid-cap core equity manager.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 3 in favor, 0 opposed, and 1 absent, the motion was approved.

3. Presentation and Discussion, and Appropriate Action Regarding ASRS International Public Equity Asset Class Policy Target Ranges

Mr. Dokes introduced the topic, explaining that asset class policy target ranges are established to provide for the flexible management of ASRS asset class investments, given daily market value fluctuations and for making tactical asset class rebalancing and relative value decisions. The recommendation to modify the ASRS Asset Allocation Policy Schematic for the International Public Equity Asset Class Policy Target Ranges to 13-23% from 13-20% would provide for opportunistic investing in institutional public equity markets.

Motion: Mr. McLaughlin moved to recommend that the Board modify the ASRS Asset Allocation Policy Schematic for the International Public Equity Asset Class Policy Target Ranges to 13-23% from 13-20%.

Mr. Thomas Connelly seconded the motion.

By a vote of 3 in favor, 0 opposed, and 1 absent, the motion was approved.

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Research Consultant Search and Award Recommendations

Mr. Dokes summarized the background of the search. In the third quarter of 2007, an Investment Research Consultant Request for Proposal (RFP) was issued to solicit responses from available and interested firms who could complement the services provided by the ASRS general consultant and to be utilized on a project basis for investment manager searches, strategic/tactical research and other special investment projects and analyses. An Investment Research Consultant(s) Search Committee (the CIO, two (2) IC members, and IMD staff) was established, which evaluated these responses and selected five (5) finalist firms. The Director served as a technical search advisor.

In late October 2007, the Search Committee interviewed the finalists. As result, Meketa Investment Group, New England Pension Consultants (NEPC) and Strategic Investment Solutions (SIS) were selected for recommendation to Mr. Matson and Mr. Wittsell, who in turn recommend them to the IC, primarily based on the assessment of these firms' ability to perform the aforementioned scope of work.

Mr. McLaughlin asked what role the IC has in choosing which consultant to use for a given project. Mr. Dokes explained that staff assesses what firm is best suited for a given project. Mr. Paul Matson, Director, explained that staff ensures that the Board Governance aspect of independence reporting is adhered to. In February 2008, he would like to discuss this process with the Board, in further detail.

Mr. Connelly moved to recommend that the full Board approve the hiring of the following firms:

- Meketa Investment Group
- New England Pension Consultant (NEPC)
- Strategic Investment Solutions (SIS)

Mr. McLaughlin seconded the motion.

By a vote of 3 in favor, 0 opposed, and 1 absent, the motion was approved.

5. Presentation, Discussion, and Appropriate Action Regarding Portable Alpha Strategies

Mr. Dokes introduced the topic. Mr. Kapanak gave a presentation providing an in depth analysis of the risks intrinsic in portable alpha and reviewing previous ASRS work on the topic of portable alpha.

Mr. Christopher Harris joined the meeting during this agenda item.

Mr. Kapanak noted that it may be more effective to favor passive management in efficient asset classes and active management in less efficient asset classes and alpha generating investment strategies. The ASRS can adjust the passive/active allocation instead of being exposed to the risks of portable alpha.

Mr. Kapanak summarized the ASRS view on portable alpha:

- The ASRS does not believe that the traditionally marketed portable alpha will meaningfully enhance investment returns.
- On a complimentary topic, the ASRS addressed the separation of beta and alpha in the 2006 Asset Allocation study and introduced the concept of an Alpha Pool.
- The Alpha Pool represents an active overlay at the Total Fund level. The Alpha Pool will consist of alpha-dominated strategies, such as absolute return strategies or market/neutral strategies. Transporting alpha back to any particular asset class is suboptimal as it may subsidize and distort asset class active returns.
- The IMD intends to work with ASRS investment research consultants to indentify and evaluate viable alpha-dominated strategies in addition to other tactical investment opportunities.

Mr. Matson commented that the ASRS is trying to identify if there are good absolute return strategies. In addition, the ASRS should focus on capturing any possible alpha without the need to port the alpha, as we could get the alpha more simply with less expense.

Mr. Dokes stated that this is an ongoing discussion and the topic will be revisited with the IC in the future.

6. Presentation, Discussion, and Appropriate Action Regarding the 2008 Investment Committee Meeting Schedule

Mr. Dokes presented the proposed 2008 IC meeting schedule, (6 meetings per year) which is consistent with the meeting periodicity, dates and times structure used in calendar year 2007. Scheduling bimonthly meetings appears to work well with IC Trustees and IMD staff; meeting periodicity allows for a manageable number of agenda items to be discussed and for sufficient time to generate associated investment material. With the concurrence of the IC Chair, additional meetings can always be scheduled given the timely nature of the topics to be discussed and actions to possibly be taken

Mr. Harris asked if 12 meetings could be scheduled, so the IC could get more involved regarding governance issues. He wondered if investment managers could come in for a symposium for a day. He also suggested that if it was found that some meetings weren't needed, they could be cancelled. Mr. Dokes noted that there is a lot of staff preparation time for the meetings, and that this may not be productive, if meetings were to be cancelled. Mr. Lawrence Trachtenberg commented that future additional meetings could always be added, as has been done in the past. He accepted the proposed schedule.

- February 6, 2008, Wednesday, 3:30 P.M.
- April 2, 2008, Wednesday, 3:30 P.M.
- June 4, 2008, Wednesday, 3:30 P.M.
- August 6, 2008, Wednesday, 3:30 P.M.
- October 1, 2008, Wednesday, 3:30 P.M.
- December 3, 2008, Wednesday, 3:30 P.M.

7. Call to the Public

No members of the public requested to speak to the IC.

The meeting adjourned at 5:08 PM.

Respectfully submitted,

Lisa Hanneman, Secretary

Date

Gary R. Dokes, Chief Investment Officer Date